

Winspear Business Reference Room
University of Alberta
1-18 Business Building
Edmonton, Alberta T6G 2R6



Cephalon Resource Corporation



Annual Report

For Year Ended
April 30, 1996.

MISSION STATEMENT

Cephalon Resource Corporation is a Calgary, Alberta based corporation engaged in the exploration, development and production of oil and natural gas in Western Canada. We plan to increase our shareholder value by drilling and developing prospects which we feel are of low to medium risk and which offer shallow to medium depth, multi-zone drilling targets. We plan to maintain a balanced mix of oil and natural gas properties in order to achieve balanced growth.

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GLOSSARY OF TERMS/CONVERSION TABLE

<u>GLOSSARY OF TERMS</u>		CONVERT	TO	MULTIPLY
bbl	barrel;	mcf	cubic metres	28.174
bopd	barrels of oil per day;	cubic metres	cubic feet	35.494
bpd	barrels per day;	bbls	cubic metres	0.159
mbbls	thousands of barrels;	cubic metres	bbls	6.290
mcf	one thousand cubic feet;	feet	metres	0.305
mcfd	one thousand cubic feet per day;	metres	feet	3.281
mmcf	one million cubic feet;	miles	kilometres	1.609
mmcfd	one million cubic feet per day;	kilometres	miles	0.62
1mstb	one thousand stock tank barrels;	acres	hectares	0.405
NGL	natural gas liquids; and	hectares	acres	2.471
stb	stock tank barrel.			

NOTICE OF ANNUAL MEETING

You are invited to attend the
Annual and Special General Meeting
of Shareholders of Cephalon Resource Corporation
at 1 p.m., Monday, September 30, 1996
and the Debentureholders of Cephalon Resource Corporation
at 3 p.m., Monday, September 30, 1996
at the Calgary Petroleum Club,
319 5th Avenue S. W., Calgary, Alberta T2P 0L5

MESSAGE FROM THE CHAIRMAN AND CHIEF EXECUTIVE OFFICER

To the Shareholders and Debentureholders of Cephalon Resource Corporation:

Accompanying this letter is the Notice, Information Circular and Form of proxy for use at the upcoming meeting.

The Corporation is at a crossroads in its development and the meetings of Shareholders and Debentureholders are extremely important to the Corporation, its Shareholders and its Debentureholders. Shareholders and Debentureholders are encouraged to participate in their respective meetings.

Amongst other things the Corporation is proposing that the Trust Indenture in connection with the Debentures be amended to allow the Corporation to redeem the Debentures on the basis of 10,000 Common Shares or the Corporation for each \$1,000 of principal amount of Debenture held, with no adjustment or other payment of outstanding interest, such interest to be waived by the Debentureholders.

In the view of management;

1. The Corporation will not be in a position to pay the outstanding interest or principal on the Debentures and without the amendment to the Trust Indenture the Corporation will not be able to redeem the Debentures in accordance with the existing provisions;
2. Bearing in mind the realizable value of the Corporation's assets and the costs that would be incurred in order to enforce the Trust Indenture and the Debentures the Debentureholders will not receive any material return on their investment if the Debentureholders take steps to enforce the Debentures;
3. The amendment to the Trust Indenture and subsequent redemption of the Debentures on the proposed basis is in the best interests of the Corporation, its Shareholders and the Debentureholders; and
4. If the proposed reorganization is successfully completed the Corporation will be able to seek new business opportunities.

Inasmuch as the Corporation will, after the redemption of the Debentures, have in excess of 29,000,000 Common Shares outstanding, management of the Corporation is proposing that the Common Shares of the Corporation be consolidated on a 5 for 1 basis.

The proposed reorganization requires the approval of the Shareholders and the Debentureholders by way of the proposed resolutions set forth in the accompanying Information Circular as well as any necessary or required regulatory approval.

Please read the accompanying Information Circular and attend the meeting. If you are unable to attend in person, please complete the enclosed form of proxy and return it to Montreal Trust Company of Canada at least 48 hours before the meeting.

We thank you for past cooperation and look forward to your continued support and involvement in the Corporation as we seek future opportunities.

Sincerely,

E. A. (Ted) Brownless,
President and Director

Richard D. Schmidt,
Chief Executive Officer

August 28, 1996

Michael A. Kociuba

Professional Corporation

Chartered Accountant

AUDITOR'S REPORT

To the Shareholders of
Cephalon Resource Corporation

I have audited the balance sheets of Cephalon Resource Corporation as at April 30, 1996 and 1995 and the statements of loss and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. My responsibility is to express an opinion on these financial statements based on my audits.

I conducted my audits in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at April 30, 1996 and 1995 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Michael A. Kociuba

CHARTERED ACCOUNTANT

CALGARY, Alberta
July 22, 1996.

CEPHALON RESOURCE CORPORATION
BALANCE SHEETS
APRIL 30, 1996 AND 1995

	<u>1996</u> \$	<u>1995</u> \$
<u>ASSETS</u>		
CURRENT		
Cash	7,035	356,823
Accounts receivable and accruals	59,720	89,169
Prepays and deposits	2,977	19,442
Temporary investments	<u>75,652</u>	-
	<u>145,384</u>	<u>465,434</u>
PETROLEUM AND NATURAL GAS PROPERTIES (Note 3)	<u>419,576</u>	<u>564,198</u>
OTHER (Note 4)	<u>-</u>	<u>152,448</u>
	<u>564,960</u>	<u>1,182,080</u>
<u>LIABILITIES</u>		
CURRENT		
Bank indebtedness (Note 5)	90,000	-
Accounts payable and accrued liabilities	310,463	229,748
Debentures payable (Note 6)	<u>1,855,559</u>	-
	<u>2,256,022</u>	<u>229,748</u>
DEBENTURES PAYABLE (Note 6)	<u>-</u>	<u>1,740,000</u>
FUTURE SITE RESTORATION	<u>41,194</u>	<u>27,470</u>
<u>CAPITAL STOCK AND DEFICIT</u>		
CAPITAL STOCK (Note 7)	2,194,940	1,918,729
DEFICIT	<u>(3,927,196)</u>	<u>(2,733,867)</u>
	<u>(1,732,256)</u>	<u>(815,138)</u>
	<u>564,960</u>	<u>1,182,080</u>

APPROVED ON BEHALF OF THE BOARD

E. S. Agnew, Jr. Director
R. J. Schmitz Director

Michael A. Kociuba

CEPHALON RESOURCE CORPORATION
STATEMENTS OF LOSS AND DEFICIT
YEARS ENDED APRIL 30, 1996 AND 1995

	1996	1995
	\$	\$
REVENUES		
Oil and gas	365,627	761,621
Royalties	(76,136)	(173,165)
Alberta royalty tax credits	16,316	32,644
Interest	4,600	13,777
Processing	656	37,099
	<hr/>	<hr/>
	311,063	671,976
EXPENSES		
Write-down of petroleum and natural gas properties	412,121	1,873,240
Depletion and amortization	232,087	463,643
General and administrative	295,570	180,916
Operating costs	200,552	296,737
Interest on debentures	174,000	101,500
Amortization - other (Note 4)	152,448	26,678
Write-down of temporary investments	23,890	-
Site restoration provision	13,724	19,288
Write-off of reorganization costs	-	32,420
	<hr/>	<hr/>
	1,504,392	2,994,422
NET LOSS	(1,193,329)	(2,322,446)
DEFICIT, BEGINNING OF YEAR	<hr/>	<hr/>
	(2,733,867)	(411,421)
DEFICIT, END OF YEAR	(3,927,196)	(2,733,867)
	<hr/>	<hr/>
Basic Loss Per Share	(0.10)	(0.22)
	<hr/>	<hr/>

Michael A. Kociuba

**CEPHALON RESOURCE CORPORATION
STATEMENTS OF CHANGES IN FINANCIAL POSITION
YEARS ENDED APRIL 30, 1996 AND 1995**

	1996	1995
	\$	\$
OPERATING ACTIVITIES		
Net loss	(1,193,329)	(2,322,446)
Items not affecting cash		
Write-down of petroleum and natural gas properties	412,121	1,873,240
Depletion and amortization	232,087	463,643
Amortization - other	152,448	26,678
Write-down of temporary investments	23,890	-
Provision for site restoration	13,724	19,288
Write-off of reorganization costs	-	32,420
	<u>(359,059)</u>	<u>92,823</u>
Net changes on non-cash working capital balances related to operations (*)	126,629	(99,763)
	<u>(232,430)</u>	<u>(6,940)</u>
FINANCING ACTIVITIES		
Issue of capital stock, net of issue costs	276,211	-
Accrued interest on debentures	115,559	-
Proceeds of debentures	-	1,740,000
	<u>391,770</u>	<u>1,740,000</u>
INVESTING ACTIVITIES		
Proceeds from sale of petroleum and natural gas property	138,496	-
Acquisition of temporary investments	(99,542)	-
Acquisition of petroleum and natural gas properties	(638,082)	(1,268,894)
Other	-	(179,126)
	<u>(599,128)</u>	<u>(1,448,020)</u>
INCREASE (DECREASE) IN CASH	(439,788)	285,040
CASH, BEGINNING OF YEAR	356,823	71,783
CASH (BANK INDEBTEDNESS, END OF YEAR	(82,965)	356,823
CASH (BANK INDEBTEDNESS, IS COMPRISED OF		
Cash	7,035	356,823
Bank indebtedness	(90,000)	-
	<u>(82,965)</u>	<u>356,823</u>
* Net changes in non-cash working capital		
Accounts receivable and accruals	29,449	130,901
Prepays and deposits	16,465	(1,523)
Accounts payable and accrued liabilities	80,715	(229,141)
	<u>126,629</u>	<u>(99,763)</u>

Michael A.Kociuba

CEPHALON RESOURCE CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

For the Years Ended April 30, 1996 and 1995

1. CONTINUED OPERATIONS

The financial statements of the Company have been prepared on a going concern basis which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The Company has incurred losses in each of the last two years and has not made a required interest payment on its debentures (see note 6). In addition, the Company has a working capital deficiency of \$ 2,110,638 (of which \$ 1,740,000 results from the reclassification of the debentures payable from a long-term liability to a current liability) and a shareholders' deficiency of \$ 1,732,256. The Company's ability to continue as a going concern is dependent upon its ability to attain profitable operations, generate working capital sufficient to meet current and future obligations and the continued support of the various creditors, lenders and debenture holders. It is not possible to predict whether any financing efforts and restructuring of debt will be successful or if the Company will attain profitable levels of operations.

The financial statements do not include any adjustments relating to the recoverability and the classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

2. SUMMARY OF ACCOUNTING POLICIES

a) Petroleum and Natural Gas Properties and Related Depletion and Amortization

The Company follows the full cost method of accounting under which all costs related to the exploration for and development of petroleum and natural gas properties are capitalized into a single Canadian cost centre. Such costs include land acquisition costs, geological and geophysical expenses, lease rentals on non-producing properties, costs of drilling both productive and non-productive wells, and related overhead charges.

The costs related to a cost centre from which there is production, together with the costs of production equipment, are depleted and amortized on the unit of production method based on the estimated proven reserves as determined by independent reservoir engineers. Natural gas reserves and production are converted into equivalent barrels of oil based upon the relative energy content.

Costs directly associated with the acquisition and evaluation of unproved properties are initially excluded from the computation of depletion. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to all other capitalized costs which are depleted.

In applying the full cost method, the Company calculates a ceiling test which restricts the capitalized costs less accumulated depreciation and amortization from exceeding an amount equal to the estimated undiscounted value of future net revenues from proven oil and gas reserves, based on current prices and costs, after deducting estimated future general and administrative expenses, future removal and site restoration costs, financing costs and income taxes, all undiscounted and unescalated. Additional depletion is provided if the net book value of capitalized costs exceeds future revenues.

Sales of oil and gas properties are accounted for as adjustments of capitalized costs, with no gain or loss recognized, unless such adjustments would significantly alter the rate of depletion and amortization by more than twenty percent.

b) Joint Ventures

Substantially all of the Company's exploration and production activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

c) Site Restoration Costs

Estimated future removal and site restoration costs, net of expected recoveries, are provided for over the life of the proven reserves on a unit-of-production basis. Costs are estimated each year by management in consultation with the Company's engineers based on current regulations, costs, technology and industry standards. Removal and site restoration expenditures will be charged to the accumulated provision account as incurred.

d) Other Capital Assets and Related Amortization

The Company provides for amortization on other capital assets using the declining balance method at an annual rate of 20%.

e) Temporary Investments

Temporary investments are carried at the lower of cost and quoted market value.

f) Flow-Through Shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. Petroleum and natural gas properties and capital stock are reduced by the estimated cost of the renounced tax deductions when the expenditures are incurred.

g) Loss Per Share

Loss per share information is calculated using the weighted average number of common shares outstanding during the year.

3. PETROLEUM AND NATURAL GAS PROPERTIES

	1996	1995		
	Cost	Accumulated Depletion, Amortization and Write-Downs	Net Book Value	Net Book Value
	\$	\$	\$	\$
Petroleum and natural gas properties, including development thereon and production equipment	3,468,505	3,070,571	397,934	541,393
Other capital assets	37,387	15,745	21,642	22,805
	<hr/>	<hr/>	<hr/>	<hr/>
	3,505,892	3,086,316	419,576	564,198
	<hr/>	<hr/>	<hr/>	<hr/>

The Company has capitalized general and administrative charges directly related to acquisition, exploration and development activities of \$ 64,835 (1995 - \$ 57,395). An additional depletion charge of \$ 412,121 (1995 - \$ 1,873,240) has been recorded to reflect a reduction in the net recoverable amount.

4. OTHER

	1996	1995
	\$	\$
Deferred finance charges	179,126	179,126
Accumulated amortization	179,126	26,678
	<hr/>	<hr/>
	-	152,448
	<hr/>	<hr/>

As a result of the non-payment of interest to the debenture holders on March 1, 1996 (see note 6), the deferred finance charges relating to the debentures, which were being amortized over the term of the debentures, have been written-off.

5. CREDIT FACILITY

The Company has a \$ 150,000 revolving demand credit facility available with a Canadian Chartered Bank which bears interest at the prime rate plus 1 1/4% per annum. As security for the facility the Company has provided a fixed and floating charge debenture over all the petroleum and natural gas properties, a general security agreement covering all of the Company's assets and an assignment of production proceeds.

6. DEBENTURES PAYABLE

On September 29, 1994, the Company issued \$ 1,740,000 of 10% convertible redeemable debentures. The debentures will mature on September 1, 1998. Each debenture will be convertible into common shares of the Company at the option of the holder at any time up to the close of business on September 1, 1996 at a conversion price of \$ 0.35 per common share and thereafter until September 1, 1998 at \$ 0.45 per common share. The debentures will not be redeemable on or prior to September 1, 1996. Thereafter the debentures will be redeemable at any time up to the close of business on September 1, 1997 for 2,000 common shares per \$ 1,000 principal amount of debentures provided the weighted average price at which the common shares have traded on the Alberta Stock Exchange during the 20 consecutive trading days ending not more than five trading days prior to the giving of notice of redemption is at least \$ 0.50. Thereafter the debentures will be redeemable at any time up to the close of business on September 1, 1998 for 1,818 common shares per \$ 1,000 principal amount of debentures provided the weighted average price at which the common shares have traded on the Alberta Stock Exchange during 20 consecutive trading days ending not more than five trading days prior to the giving of notice of redemption is at least \$ 0.55.

On March 1, 1996 the Company did not make the semi-annual interest payment of \$ 87,000 to the debenture holders. The failure to make the scheduled interest payment caused an event of default to occur and gave the debenture holders the right to accelerate payment on the debentures and/or exercise their right to seize assets. As a consequence, the debenture holders are in a position to claim payment in full of the outstanding principal of \$ 1,740,000 and accrued interest of \$ 115,559. As of the audit report date no action has yet been commenced by the debenture holders.

7. CAPITAL STOCK

a) Authorized

Unlimited number of common voting shares of no par value Unlimited number of preferred shares of no par value

b) Issued

	Number Common Shares #	1995 Stated Value \$
Balance - April 30, 1994	10,676,020	2,057,621
Tax effect of flow-through	-	(138,892)
Balance - April 30, 1995	10,676,020	1,918,729
Issued in exchange for petroleum and natural gas property (see note 9(a))	1,000,000	250,000
Issued pursuant to rights offering	218,426	26,211
Balance - April 30, 1996	11,894,446	2,194,940

c) Stock Options

The following options to purchase shares are held by directors, officers and employees of the Company as at April 30, 1996:

Number of Shares	Exercise Price Per Share	Expiry Date
900,000	\$ 0.12	September 1, 1997

Subsequent to April 30, 1996, as a result of the resignation of a certain option holder, 175,000 of the above options expired.

d) Escrow

As at April 30, 1996 - 1,668,667 (1995 - 2,003,333) common shares are held in escrow by the transfer agent subject to the direction or determination of the relevant regulatory authorities.

8. INCOME TAXES

The provision for income taxes reflects an effective tax rate which differs from combined federal and provincial statutory tax rates. The main differences are summarized as follows:

	1996 \$	1995 \$
Loss before income taxes	(1,193,329)	(2,322,446)
Corporate tax rate	45%	44%
Calculated income tax provision	(536,998)	(1,021,876)
Increase (decrease) in taxes resulting from:		
Non-deductible depletion	101,301	184,554
Crown royalties and crown lease rentals	14,819	32,519
Resource allowance	-	(20,326)
Alberta royalty tax credits	(7,342)	(14,363)
Share issue costs	(14,328)	(14,010)
Other	-	1,061
Future tax benefits not recognized	442,548	852,441

The Company has incurred losses for income tax purposes of approximately \$ 685,400, the related benefit of which have not been recorded in the financial statements. Unless sufficient taxable income is earned, these losses will expire as follows:

\$
2001 - 169,400
2002 - 44,800
2003 - 471,200

As at April 30, 1996, the Company has available for deduction against future taxable income the following amounts:

	<u>Annual Rate of Claim</u>
Canadian oil and gas property expenditures	1,076,200 / 10%
Canadian development expenditures	475,600 / 30%
Canadian exploration expenditures	267,500 / 100%
Capital cost allowances	592,000 / 20-50%
Unamortized debenture issue costs	107,500 / 20%
Unamortized share issue costs	68,200 / 20%
Cumulative eligible capital	31,900 / 7%

9. RELATED PARTY TRANSACTIONS

- a) During the year ended April 30, 1996 the Company acquired a right to earn an interest in a petroleum and natural gas property from a company controlled by certain officers and directors of the Company for a total consideration of \$ 550,000 satisfied by cash of \$ 300,000 and the issuance of 1,000,000 common shares from treasury (of which 672,000 common shares are subject to an escrow agreement) at an ascribed value of \$ 0.25 per common share. As part of the agreement, the Company was to complete and fulfill certain obligations in order to earn its interest in the property. The operator of the property has indicated to the Company that the obligations have not been completed. Discussions between the Company and the operator are ongoing and as of the audit report date the parties have not yet resolved the issue.
- b) Certain consulting services were provided to the Company by companies controlled by officers and directors of the Company. The cost of such services was \$ 62,800 (1995 \$ 18,200; \$ 23,360 (1995 - \$ nil) of such services was included in general and administrative expenses and \$ 39,440 (1995 - \$ 18,200) was included in petroleum and natural gas properties.
- c) Certain consulting services were provided to the Company by companies controlled by former officers and directors of the Company. The cost of such services was \$ 34,145; \$ 8,750 of such services was included in general and administrative expenses and \$ 25,395 was included in petroleum and natural gas properties.

10. CONTINGENCY

The Company activities are subject to various government laws and regulations relating to the protection of the environment. These environmental regulations are continually changing and generally becoming more restrictive. The Company believes its operations comply in all material respects with all applicable laws and regulations.

DIRECTORS' PROFILE

Richard D. Schmidt

Chief Executive Officer, Director

Mr. Schmidt attended the University of Saskatchewan and studied in arts and sciences. From 1955 to 1985, he acquired extensive experience in the geophysical and seismic fields, and from 1985 to 1993, served as President of Golden Pacific Corporation, an Alberta Stock Exchange listed company. Thereafter, he was Chairman and President of Rico Resources Inc. until 1993 when he became Chairman and C.E.O. of Chipman Energy Limited, an ASE listed company, a position which he resigned in March, 1995.

Edward A. Brownless

President, Chairman of the Board & Director

A graduate of the University of Toronto, with a degree in Mining Geology and Engineering, and a consulting geologist since 1965, Mr. Brownless is President and Director of Provost Petroleum Ltd. Prior to that he was President of RioAlto Exploration Ltd. His geological and development background dates back to 1950 including a fifteen year tenure of a geological position with Chevron Standard. He was a member of the Alberta Society of Petroleum Geologists and is currently a life member of the Alberta Association of Professional Engineers, Geologists and Geophysicists. (APEGGA).

Ian D. Henderson, P. Eng. (MBA).

Director

Mr. Henderson has over 19 years of experience in the petroleum industry primarily as an oil and gas consultant with large engineering consulting firms. Mr. Henderson has also been a founding director and shareholder of several large public companies including Clayoquot Resources Ltd., Encal Energy Ltd. and Virtual Dynamics Corp. Mr. Henderson is currently a director and president of Clayoquot Resources Ltd. and a director of Nycan Petroleum Corp. which traded on The Alberta Stock Exchange. For the past five years, Mr. Henderson has managed Henderson & Associates Petroleum Consultants Ltd. which manages oil and gas properties and provides consulting services to major oil companies for asset rationalization.

CORPORATE INFORMATION

BOARD OF DIRECTORS

Richard D. Schmidt
CEO

E. A. Brownless
President & Chairman

Ian D. Henderson, P.Eng. (MBA).
Director

CORPORATE OFFICE

1600, 717 7th Avenue S. W.,
Calgary, Alberta T2P 0Z3

REGISTRAR AND TRANSFER AGENT

Montreal Trust Company of Canada
Calgary, Alberta

The Alberta Stock Exchange
Symbol: "CHR"

CONSULTING ENGINEERS

Fekete Associates Inc
Calgary, Alberta

OFFICERS AND PERSONNEL

Richard D. Schmidt
CEO

E. A. Brownless
President & Chairman

Ian D. Henderson, P.Eng. (MBA).

Andrea van Remmen
Secretary/Receptionist

Judy Pitt
Accountant

AUDITORS

Michael A. Kociuba
Professional Corporation
Chartered Accountant
Calgary, Alberta

SOLICITORS

Gregory C. Collver,
Barrister & Solicitor,
Calgary, Alberta

PRINCIPAL BANKER

Alberta Treasury Branches
Calgary, Alberta

CEPHALON RESOURCE CORPORATION

**1600, 717 7th Avenue S. W.,
Calgary, Alberta T2P 0Z3
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ASE: Trading Symbol CHR**